EUROPEAN FILE

Towards a big internal market in financial services

COMMISSION
OF THE EUROPEAN
COMMUNITIES

November 1988
17/88

The Treaty of Rome's provisions for the creation of an internal market include the services sector and cover financial services (banking, insurance, dealing in securities and stocks). In the period from 1958 to 1985, there was considerable progress in this direction but the objective was not achieved.

The European Commission's 1985 White Paper on completing the internal market called for a new impetus. Its aim was to weld together the 12 separate national economies into a single market – a single European economy – by 1992. The White Paper programme was approved by the European Community Heads of State or Government and given a constitutional basis by the Single European Act of 1986, which amends the Community Treaties and defines the internal market as 'an area without internal frontiers in which the free movement of goods, services, persons and capital is ensured'.

The White Paper argued that a common market already existed to a large extent for goods and that it was important to make similar progress in services, particularly in financial services which play a vital role in the European economy.

A major sector

The financial services sector is of growing importance to the Community economy. In terms of output, it accounts for about 7% of gross domestic product (GDP) for the Community as a whole, varying from 14% in Luxembourg to 4.5% in France. In terms of employment, the sector provides about 3 million jobs or about 3.5% of total Community employment, varying from 7% in Luxembourg to about 2.5% in Italy.

Financial services are an important input to the rest of the Community's economy. Nearly half of the total profits of credit and insurance institutions is reinvested in other industries. Yet financial services have not benefited to the same extent as manufacturing industry from the progress made towards dismantling barriers to trade between Member States.

The present situation

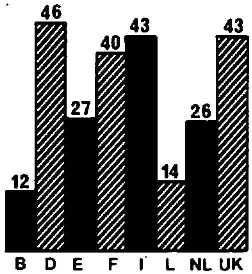
The achievement of the internal market in financial services will be the culmination of developments which have been under way for some time. Highly integrated markets already exist in reinsurance (insurance of insurers) and transport insurance; there are branches of Community banks in most of the Community's main financial centres; a large number of securities are listed on the stock exchanges of more than one member country.

The hard fact remains that government regulations, imposed for prudential or safety reasons, have the effect of hindering financial institutions from setting up in another Member State or offering services there. Market openness, competition and cost efficiency are often not possible.

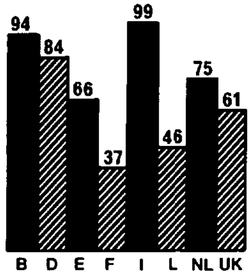
Also, for some time now changes have been taking place in the environment in which European financial services institutions operate:

Why should there be an internal market in financial services: Some comparative prices from different Community countries (ECU)

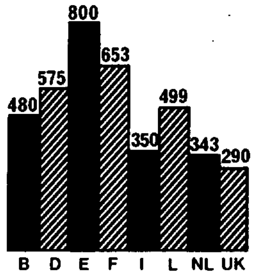
Banking services



Consumer credit: annual cost of a consumer loan of 500 ECU [1]

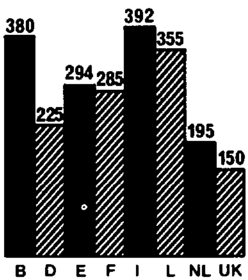


Credit cards: annual cost of 500 ECU debt [1]

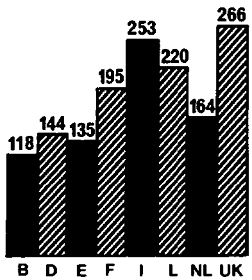


Mortgage: annual cost of a home loan of 25 000 ECU [1]

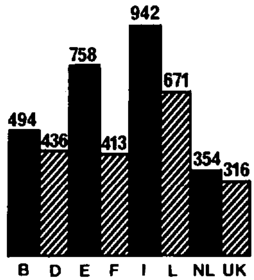
Insurance services



Life insurance: average annual cost of 5 and 10-year term policies for a range of ages

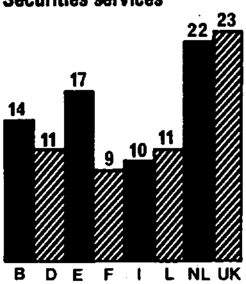


Home insurance: annual cost of fire and theft cover for home in medium-sized town valued at 70 000 ECU with 28 000 ECU contents

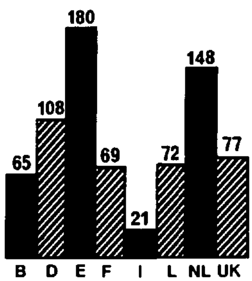


Motor insurance: annual cost of comprehensive insurance for 1.6 litre car — full no-claims bonus

Securities services



Private equity transaction: commission costs of cash bargain of 1 440 ECU



Private gilts transaction: commission costs of cash bargain of 14 000 ECU

Source:
'Research on the cost of non-Europe' Basic findings, Vol. 9. 'The cost of non-Europe in financial services', a study carried out for the Commission of the European Communities.

[1] Difference between interest rates and national money market rates.

- ☐ The market is increasingly globalized and organized at world level. Financial services companies can move capital – and even their own location – very quickly between continents.

- ☐ The development of new telecommunications and information technology have reinforced the globalization process and ensured the rapid spread of innovation and new financial products.

- ☐ Increased competition between different kinds of financial institutions is blurring the distinctions between banking, insurance and securities firms.

- ☐ There is increased competition too, between financial institutions in Europe and those in the USA and Japan.

World financial markets are rapidly moving to continuous 24-hour trading, based on three principal time zones centred on the USA, Europe and the Far East. The European market must organize itself to compete at the world level.

Why a European financial services market?

A Community market in financial services offers many advantages:

- ☐ National laws on their own can no longer provide the basis for future developments, particularly in the face of increasing globalization. If Europe is not to lose its share of the business, and of the employment that goes with it, it is essential that an efficient and open Community market develops in the financial services sector.

- ☐ From the consumer's point of view, it is important that he or she should have access to a wide range of competing financial products irrespective of their country of origin.

- ☐ It is essential for the competitiveness of the manufacturing sector that the financial sector be as competitive as possible.

- ☐ The financial services industry itself needs to get in shape to face the challenge from the USA and Japan.

The report prepared for the Commission in March 1988, on the cost of non-Europe in financial services, shows significant potential economic gains to be made from completing the internal market. It estimates that, in terms of benefits to consumers, there could be a once-and-for-all gain of between 11 and 33 billion ECU, with the central estimate being 22 billion ECU[1]. There would also be potential gains from equalization of interest rates.

---

[1] 1 ECU (European currency unit) = about £ 0.65, Ir £ 0.77 or US $ 1.1 (at exchange rates current on 28 September 1988).

The report also concludes that the benefits of the internal market will come not only from removing the costs due to existing barriers to trade in financial services, but also from the new impetus that will be given to further trade. This will mean more competition, which will result in both increased opportunities for the financial services industry and reduced costs for consumers. It will also offer greater freedom of choice to the consumer, who will be able to take the initiative and approach suppliers of financial services in other Member States in order to obtain the best terms and conditions.

The basis of the internal market in financial services

The single market in financial services must be founded on three major freedoms:

- ☐ The freedom of financial services institutions to establish their activities and to set up branches wherever they wish within the Community.

- ☐ The freedom of those same institutions to offer their own particular financial services products across Community frontiers without having to be established in other Member States.

- ☐ Freedom of capital movements throughout the Community.

The Community's legislative programme is designed to remove all the restrictions and obstacles which interfere with these freedoms.

- ☐ *Liberalization of capital movements* is the backcloth to the whole Community approach to freedom of financial services.

  - Already in the early 1960s, direct investment and portfolio investment in quoted shares and bonds were liberalized.

  - In 1986 the Community's Council of Ministers adopted a Directive extending the list of liberalized transactions to include long-term loans, unquoted securities and the issuing of foreign securities on domestic markets.

  - In 1988 the Council approved Directives to liberalize all other transactions: short-term monetary instruments, current and deposit account operations, financial loans and credits.

  When all of these Directives are in force – and Member States are obliged to amend their national legislation within a certain time limit – all Member States will be obliged to ensure that:

- Their residents have access to the financial systems of the other Member States and to all the financial products available in those States.

- There are no restrictions on capital transfers.

- There are no other discriminatory measures that will frustrate or distort the free movement of capital.

☐ *Freedom of establishment and freedom of services.* Liberalization of capital movements is not in itself sufficient to bring about freedom of financial services:

- Barriers caused by differing national regulations would obstruct freedom of establishment and free trade in financial services even when exchange controls are fully removed.

- If there are no common rules for the supervision of financial institutions business will tend to migrate to centres where supervision is most lax.

- There must be broadly equivalent standards for protection of investors.

Building on the basic principles of the Treaty and on legislation already adopted by the Community, the general method of achieving these objectives which the White Paper on the internal market adopts is:

- The harmonization of essential standards for prudential supervision of financial institutions and for the protection of investors, depositors and consumers.

- Mutual recognition by the supervisory authorities of financial institutions in each Member State of the way in which they apply those standards.

- Based on those first two elements, 'home country control and supervision' (control and supervision by the Member State in which the financial institution is based) of financial institutions that wish to operate in other Member States either by establishing in them or by offering their services directly across frontiers.

For the banking and securities sectors the central concept is a single licence, issued in one Member State, which allows a financial institution to offer its services in other Member States, either by establishing a branch or operating directly across frontiers. The services offered must be ones which the institution is allowed to provide in its home country.

In the insurance sector, however, supervisory control will be divided between the Member State where the insurance company has its head office and the one where an agency or branch is established.

Community law in specific areas of financial services

☐ *Banking*

A first banking coordination Directive was adopted in 1977 and achieved three main goals.

It cleared away most of the obstacles to freedom of establishment of banks and other credit institutions.

- It laid down common standards for the granting of banking licences.

- It introduced the basic principle of home country control.

There are still obstacles to be removed before a genuinely unified Community banking market can exist:

- A bank or other credit institution still needs authorization from 11 different supervisors to set up branches in all Member States.

- Banking services cannot be provided across frontiers in all Member States.

- Banking activities have not been defined.

With the aim of removing all of these barriers, the Commission proposed a second banking coordination Directive in 1988.

- It puts forward the idea of a single banking licence, valid throughout the European Community, which will authorize a bank or credit institution to supply its services throughout the Community either by branches or directly.

- National supervision authorities in the Member States will recognize the licences issued by each other.

- A list of banking activities is laid down, including not only the main traditional services but also ones that are new for some Member States (e.g. trading in securities).

- A minimum level of capital (own funds) is laid down for new banks.

- Supervisory rules are spelt out in respect of internal management and audit systems.

Further legislation is necessary to ensure equal competition between banks and credit institutions within the Community and to prevent the migration of banks to countries with less strict supervision. Such measures include:

- A Directive for a harmonized solvency ratio, which will lay down high common standards for the solvency of banks and other credit institutions.
- Rules on guarantees for depositors and on limitation of large risks undertaken by credit institutions.
- Rules on the annual accounts of banks and on harmonizing the concept of a bank's 'own funds'.

In the field of mortgage credit, legislation will enable different forms of such credit to be provided throughout the Community by the various national institutions that specialize in it.

Other initiatives in the banking sector concern ground rules for consumer credit operations and electronic means of payment. In the latter case the aim is to ensure that a payment card issued in one Member State can be used throughout the Community.

☐ *Insurance*

Freedom of establishment of insurance companies was instituted in the 1970s by the first Directives on non-life insurance and life insurance. Motor insurance directives were also adopted, abolishing frontier controls for green cards and reducing divergences in obligatory motor insurance cover. Progress towards freedom of services has been much slower.

Following major judgments by the European Court of Justice in December 1986, on freedom of services in the insurance sector, the Council adopted in 1988 a second Directive on non-life insurance which provides for:

- Some harmonization of national laws concerning direct non-life insurance.
- Freedom to provide services for large risks in the industrial, commercial and transport sectors.
- Free access to the Community market for large policy holders and insured parties.

Since the Court ruled that mass consumers of insurance ('the man in the street') needed a greater degree of protection than large policy holders and that more detailed harmonization was required where such mass consumers were concerned, separate specific legislation will be drawn up at a later stage.

The same principle of freedom to provide services, and thus of free access to the Community-wide market for policy holders and insured parties, will also apply to legislation on life insurance policies and on compulsory motor insurance. These will equally take into account the need to ensure full protection for the individual consumer.

Other legislation to cover the interests of insurance companies' debtors, creditors and policy holders will deal with the harmonization of the companies' annual accounts and of the procedures for winding up insurance companies.

☐ *Securities and stock markets*

The main objectives in the securities market sector are:

- To make it easier for companies to treat the Community as a single market for the issue of shares and bonds and for obtaining stock exchange listing.
- To ensure by full and proper disclosure of information that all investors are provided with the information they need to make the proper assessment of the risks associated with an investment.
- To ensure that all Member States will be in a position to recognize any public offer prospectus approved in any one Member State.
- Mutual recognition of authorizations granted to companies providing investment services in the securities field (broking, dealing, portfolio management).

Two Directives should enable these objectives to be achieved:

- A Directive liberalizing the activities of undertakings for collective investment in transferable securities (Ucits, sometimes known as unit trusts or mutual funds). A Ucits authorized by its own Member State will be allowed to market its units to investors in any other Member State. This was adopted in 1985 and enters into force in October 1989.
- An Investment Services Directive which will facilitate free competition between brokers, dealers and portfolio managers while ensuring proper standards of solvency and investor protection.

Other legislation deals with:

- Harmonizing the conditions for the admission of securities to official stock exchange listing (Directive adopted in 1979).
- Harmonizing the requirements for the listing particulars to be published for the admission of securities to official stock exchange listing, including the mutual recognition of listing prospectuses (Directives adopted in 1980 and 1987).

- Information to be published on a regular basis by companies whose shares have been admitted to official stock exchange listing (Directive adopted in 1982).

- Harmonizing the contents of the public offer prospectus.

- The prohibition of insider trading.

- Information to be published when major shareholdings in a listed company are acquired or disposed of.

Δ

The objective of the Community is to establish by 1992 a single European market in financial services, where a bank can offer the full range of its services throughout the entire Community and set up branches in another Member State as easily as in its own, where insurance can be bought on the most reasonable terms and be valid throughout the Community, and where the market for securities and capital is of a size sufficient to meet the financing needs of European industry and attract investors from all over the world ■

The contents of this publication do not necessarily reflect the official views of the institutions of the Community. Reproduction authorized.

Commission of the European Communities

Directorate-General for Information, Communication and Culture
Rue de la Loi 200 – B-1049 Brussels

Information offices (countries fully or partially English speaking*)

Ireland	39 Molesworth Street, Dublin 2 – Tel. 71 22 44
United Kingdom	8 Storey's Gate, London SW1P 3AT – Tel. 222 81 22 4 Cathedral Road, Cardiff CF1 9SG – Tel. 37 16 31 7 Alva Street, Edinburgh EH2 4PH – Tel. 225 20 58 Windsor House, 9/15 Bedford Street, Belfast BT2 7EG – Tel. 24 07 08
USA	2100 M Street, NW, Suite 707, Washington DC 20037 - USA – Tel. (202) 862-9500 245 East 47th Street, 1 Dag Hammarskjöld Plaza, New York, NY 10017 - USA – Tel. (212) 371-3804

* Offices also exist in other countries including all Member States.

Office for Official Publications
of the European Communities
L - 2985 Luxembourg

ISSN 0379-3133

Catalogue number: CC-AD-88-017-EN-C

EN